Financial Markets

Irving Trust

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A double-barreled easing by the Fed, a sharp swing back to big price gains and interest rate drops in credit markets--all told, a busy week. Early on, last week's price erosion continued, but this reversed when Tuesday's Federal Open Market Committee meeting was followed by an emphatic drop in Fed funds, which were allowed to fall to 9.25% before the Federal Reserve intervened.

Rates tumbled on this easing move, then dropped again after Thursday evening's announcement of Step Two in the dismantling of the Federal Reserve's March 14 credit control program. The outlines of the program remain, but several key elements were relaxed--noninterest-bearing special deposits on new consumer loans and increases in money market fund issuance were cut from 15% to 7.5%, the base on reserve requirements on managed liabilities was increased and the requirement cut from 10% to 5%, and bank credit growth guidelines were eased.

The Fed's vigorous easing was a surprise to some observers (including this one) who had argued that the sharp surge in money growth would lead the central bank to encourage an interest rate plateau. Instead, the Fed seems to be focusing on the continuing sharp deterioration in economic activity and on the improving inflation outlook. This week saw report of a 4.2% April drop in durable goods orders, the smallest nominal personal income gain in five years, and an April rise in the savings rate to 4.2%, from 3.4% in December. April's consumer price inflation number, in contrast, was good news--the 0.9% gain was the smallest rise in over a year. With the recession deepening more rapidly than expected and inflation easing off, some shift in Fed priorities may be taking place.

Swings in Treasury bill rates gave a clear reading of the sharp shift in market mood. Rates in Monday's regular week auction rose for the first time in seven weeks, with 13-week bills at 8.95%, from 8.60% in last week's auction, and 8.12% in interauction secondary trading. By Friday, however, 13-week bills were down to 7.50%. Other short-term rates moved with bills; prime rate drops accelerated (most big banks are now at 14.5%) with cuts in marginal reserve requirements.

The discount rate (still at 13%) has been left high and dry, and many look to a cut very soon. Foreign exchange market considerations could be delaying this, since forex markets are traditionally very sensitive to discount rate changes. With the latest policy easing, however, the Federal Reserve seems to be shifting to a slightly more activist approach to dollar support in forex markets, a stance that could cushion repercussions on the dollar of a discount rate cut.

Longer-term markets rallied as well, with intermediates particularly strong--rates are low enough to bring borrowers to market, but uncertainty is still high enough to make five-to-ten year maturities attractive, given the return to a positive yield curve. The corporate market was especially buoyant, cheerfully absorbing record new supply despite the prospect of a June calendar that could well exceed May's record. Municipals were less positive, with the Bond Buyer Index (which is weighted to the long end) up 30 basis points over the week. This reflected hesitant retail demand and oversupply in longer maturities; intermediates performed considerably better.

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Market Yields

	5/23/80	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company			
Short-term loans to substantial depositors	(noon)		
with highest credit rating	14.50	16.50	11.75
Effective since	5/23/80		
Discount Rate at Federal Reserve Bank	13.00	13.00	9.50
Federal Funds	8.75	11.63	10.25
Repurchase Agreements	8.25	10.25	9.90
U.S. Treasury Issues			
Bills			
3 months	7.85	9.30	9.90
6 months	8.20	9.42	10.00
1 year	8.45	9.58	9.81
Coupons			
2 years	8.65	9.64	9.52
4 years	9.35	9.84	8.98
7 years	9.68	10.20	8.98
10 years	9.80	10.30	9.00
Long Bond	10.08	10.47	9.04
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.45	10.25	10.08
3 months	8.50	10.25	10.12
6 months	8.40	10.10	10.18
1 year	9.00	10.20	10.20
Banker's Acceptances			
1 month	8.10	9.80	10.00
3 months	8.15	9.95	10.12
6 months	8.35	10.10	10.18
Eurodollar Deposits			
1 month	8.94	10.38	10.25
2 months	9.25	10.69	10.44
3 months	9.50	11.13	10.56
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	4.00	9.25	9.00
1 month	8.00	9.00	9.90
3 months	8.00	8.88	9.88
Bank Holding Companies			
1 month	8.25	9.50	9.75
Dealer Placed:			
3 months	8.25	9.50	9.95
New AA Corporate Utility Bond	11.50	11.85	9.95
Tax Exempt			
6 month Project Notes	4.90	5.50	4.90
1 year AAA Bond	5.00	5.40	N/A
5 year AAA Bond	5.20	5.70	N/A
20 year AAA Bond	6.75	6.90	5.70

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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